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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of )  
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Section 272(f)(1) Sunset of the BOC )  
Separate Affiliate and Related )  
Requirements )  
\_\_\_\_\_ )

WC Docket No. 02-112

COMMENTS OF AT&T CORP.

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**COMMENTS OF AT&T CORP.**

AT&T Corp. ("AT&T") respectfully submits these comments in response to the Commission's Notice of Proposed Rulemaking, *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, FCC 02-148, (May 24, 2002) ("Notice").

**INTRODUCTION AND SUMMARY**

Most of the country's lawmakers and regulators are pursuing a variety of actions designed to ensure that large corporations – even those in highly competitive industries – are subject to appropriate controls regarding their accounting and auditing methods and their transactions with closely-held affiliates. These actions uniformly seek to impose more stringent obligations and oversight designed to make these corporate activities *more* transparent to the public. It would be truly remarkable for the Commission, at this time, to take the diametrically opposite path and *relax* separate accounting, independence, nondiscrimination and other section 272 safeguards imposed by Congress on the Bell Operating Companies ("BOCs") – firms that are not subject to any effective competition and that have a long and sordid history of discrimination and accounting gimmicks to favor their affiliates. Nor would it escape notice if, as the rest of the nation seeks to *strengthen* the audit standards and procedures, the Commission *eliminated*

altogether the existing biennial audits of the BOCs' affiliate transactions – in the face of mounting evidence that even superficial audits have exposed undeniable proof that BOCs are in fact abusing their affiliate relationships.

The BOCs will argue that the elimination of these important safeguards is compelled by the Communications Act and by marketplace conditions, but that is patently false. Congress enacted the section 272 structural and accounting safeguards in 1996 precisely because it recognized that the unusual market structure in this industry made it *more* likely that the BOCs would require oversight. Congress recognized that, even after BOCs opened their local markets to competition and received approval pursuant to section 271 to offer in-region long distance services, BOCs would remain dominant in their local markets. It would take significant time for numerous competitors to establish viable and ubiquitous alternative sources of local services that could act to constrain the BOCs' market power, and for local competition to be truly robust. Congress was aware, for example, that AT&T's dominance in the long distance market was not found to have dissipated until eleven years after it divested control of the local bottleneck facilities that the BOCs now control. Accordingly, Congress established the section 272 safeguards to apply to BOCs during the time period – however long – that a BOC's market power persists after long distance entry, so that any anticompetitive behavior could be more easily detected and remedied.

The section 272 safeguards require BOCs to offer interLATA services only through a truly separate affiliate that must “operate independently” from and on an “arm's length” basis with the BOC. 47 U.S.C. § 272(b). The long distance affiliate must maintain “separate” “books, records, and accounts” from the BOC, utilize “separate officers, directors, and employees” from the BOC and make available for public inspection “any” transactions between

the BOC and its affiliate. *Id.* Congress also adopted nondiscrimination safeguards, which include an unqualified prohibition against discrimination by a BOC in its dealings with its affiliate, as well as requirements that the BOC fulfill various requests for service by competitors on the same terms that the BOC provides to itself or its affiliates. *Id.* §§ 272(c), (e). And although these safeguards were themselves designed to make a BOC's dealings with its affiliate more transparent, Congress also sought to ensure that there would be strict oversight of the BOC's compliance with section 272 safeguards after it received section 271 approval, by allowing the Commission to suspend or revoke such approvals if the BOC failed to comply with section 272 and by requiring biennial audits that would fully test such compliance. *Id.* §§ 271(d)(3)(B), 271(d)(6); 272(d). Congress provided that section 272 would apply for a *minimum* of 3 years after a BOC received section 271 authority. *Id.* § 272(f)(1). However, in recognition that BOC market power may not dissipate that quickly, Congress directed the Commission to extend those requirements as necessary. *Id.*

The *Notice* asks whether the Commission should extend the section 272 safeguards. The answer to that question plainly depends upon whether BOCs' can be expected to retain market power three years after they receive interLATA authority. If BOCs are likely to maintain market power and the ability to discriminate against rivals and to misallocate costs after the three year initial section 272 term expires, then the section 272 safeguards must be extended.

As demonstrated below, there can be no doubt that all of the section 272 safeguards should be extended to all BOCs, for at least another three years. It is indisputable that, even where the BOCs have been approved under section 271 and been found to have opened their markets to competition, local markets are nowhere near the robust competition that Congress intended and that is necessary to dissipate BOC local market power. To the contrary, development of local competition even in large states has been "anemic," and, as the Chairman

recently acknowledged, has occurred at a much slower pace than the Commission expected. Even in New York, the first state in which a BOC received section 271 approval and one of the states most attractive to local competitors, state regulators have found that years after section 271 approval, the BOC there “continues to dominate the market” for key services and still controls bottleneck facilities upon which its rivals remain dependent. And in Texas, the second state receiving section 271 authority, the comments of the Public Utility Commission of Texas support extension of the section 272 safeguards because, among other reasons, the “lack of alternative access points to [BOC] network.” Under these market conditions, it would be unthinkable for the Commission – alone among lawmakers and regulators – to determine that structural, transactional, and nondiscrimination safeguards should be *removed*, rather than strengthened and more vigorously enforced.

As detailed below, the BOCs’ own conduct provides the best demonstration of their enduring market power and the immediate need for increased attention to and continued application and enforcement of section 272 safeguards. The BOCs have consistently engaged – and continue to engage, even in states in which they have obtained section 271 authority years ago – in the very types of misconduct that Congress expected would occur in the period after section 271 authority is granted but before full competition developed to constrain local market power. The evidence AT&T has compiled – which includes findings from regulators and independent auditors – shows, for example, that BOCs provide the special access services that are a key input into long distance services in a discriminatory manner that treats the BOCs’ rivals less favorably than the BOCs’ retail customers. And BOCs have also been found to inflict harm on the long distance market by implementing PIC changes and PIC freezes – the processes by which long distance carriers win and retain their customers – in a discriminatory fashion. These findings

confirm the BOCs' enduring local market power and also demonstrate that section 272 safeguards remain critical for competitors and regulators to detect and measure the BOC misconduct in the first instance.

The BOCs also continue to engage in pervasive and improper cost misallocation, which aids the BOCs' long distance affiliates and harms their unaffiliated rivals. In Texas, for example, SBC is failing to impute access charges to itself, and is offering through its affiliate long distance services at rates that are nearly equal to the BOC's intrastate access charges. This is a classic price squeeze that again demonstrates the BOCs' continued market power and the need for enforcement of section 272 safeguards to detect and remedy such conduct. Additionally, BOC long distance affiliates are receiving huge anticompetitive advantages through the receipt of BOC marketing services and assets at extremely low prices that "clearly demonstrate cross-subsidization."

Such conduct would be almost impossible to police if section 272 accounting and structural safeguards were not in place. Thus, both theory and marketplace evidence compel the conclusion that the Commission should promulgate a blanket continuation of all section 272 safeguards for at least three years, and provide an ample basis for the Commission to reject any of the less robust alternatives proposed in the *Notice*.

These comments are organized as follows: Part I.A sets forth the Congressional intent behind section 272. Although Congress indicated that the provisions of section 272 should eventually sunset, the initial three-year period provided therein was intended to be the *first* point at which the relevant test for assessing the propriety of the sunset was to be applied: whether the relevant local markets fully competitive and has the BOCs' market power been fully dissipated. Part I.B demonstrates that the BOCs to date continue to retain market power in all local markets,

including those in which they have long had authority to offer interLATA services. Part I.C provides evidence of the numerous instances in which BOCs, using this market power, have engaged in discrimination in favor of their affiliates and their customers, and have otherwise disadvantaged their rivals. Moreover, this evidence shows that the presence of the section 272 safeguards has been essential for detecting virtually all of this misconduct. Part I.D explains why the two biennial audits conducted to date do not provide evidence that would support the sunset – and in fact demonstrate that retention of the section 272 safeguards is necessary. Further, reliance only on biennial audits (which to date have been conducted under the requirement that the BOCs and their long distance operations must be structurally separate) cannot adequately police BOC conduct if section 272 is allowed to sunset. Part I.E shows that the benefits of the section 272 safeguards far outweigh their costs.

Part II.A explains that, because the BOCs retain market power, and local competition has been proceeding at an anemic pace, the Commission should continue to apply all of the section 272 safeguards to all BOCs for an additional three years. The remainder of Part II demonstrates that alternatives identified in the *Notice* would be unreasonable and inconsistent with the purposes of the Act.

**I. THE COMMISSION SHOULD EXTEND THE REQUIREMENTS OF SECTION 272 TO ALL BOCS FOR AN ADDITIONAL THREE YEARS.**

**A. So Long As the BOCs Retain Local Market Power, the Section 272 Safeguards Will Remain Essential Tools For Promoting Competition In All Telecommunications Markets.**

Section 272 of the Communications Act, 47 U.S.C. § 272, was enacted to bridge the gap between the “fundamental postulate underlying modern telecommunications law” – that the BOCs will “have both the incentive and ability to discriminate against competitors in incumbent LECs’ retail markets” until their monopoly local telephone markets become fully

competitive, *SBC/Ameritech Merger Order* ¶¶ 12, 190 – and the section 271 command that BOCs be allowed to provide in-region long distance services when their local markets are merely open to competition.<sup>1</sup> Section 272 thus reflects Congress’ recognition that, even after a BOC is permitted to provide in-region interLATA service in a state, it will continue to have substantial market power in its local markets in that state. Section 272 targets the core concern that the BOC will leverage this local market power both to undermine existing competition in the long-distance market and to stifle fledgling competition in those local markets.

For these reasons, the Commission has frequently stressed that “compliance with section 272 is ‘of crucial importance’ because the structural, transactional, and nondiscrimination safeguards of section 272 seek to ensure that BOCs compete on a level playing field.” *Texas 271 Order* ¶ 395.<sup>2</sup> Among other obligations, section 272 requires a BOC, after obtaining section 271 authority, to provide long distance and other services through independent and separate affiliates and to afford competing carriers the same treatment it provides to these affiliates. *See* 47 U.S.C. § 272; *Non-Accounting Safeguards Order*,<sup>3</sup> *Accounting Safeguards Order*.<sup>4</sup> In particular, these separate affiliate and related requirements are “designed, in the absence of full competition in the local exchange marketplace, to prohibit anticompetitive discrimination and cost-shifting.” *Non-*

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<sup>1</sup> Memorandum Opinion And Order, *Applications Of Ameritech Corp., Transferor, And SBC Communications Inc., Transferee, For Consent To Transfer Control Of Corporations*, 14 FCC Rcd. 14712 (1999) (“*SBC/Ameritech Merger Order*”).

<sup>2</sup> Memorandum Opinion And Order, *Application By SBC Communications Inc., et al., Pursuant To Section 271 Of The Telecommunications Act Of 1996 To Provide In-Region, InterLata Services In Texas*, 15 FCC Rcd. 18354 (2000) (citation omitted).

<sup>3</sup> First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21905 (1996) (“*Non-Accounting Safeguards Order*”).

<sup>4</sup> Report and Order, *Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd 17359 (1996) (“*Accounting Safeguards Order*”).

*Accounting Safeguards Order* ¶ 9. And contrary to the *Notice's* reference to cost misallocation and discrimination rules as “residual concerns” (¶ 18), such restrictions lie at the very heart of the Act (as the Commission previously has recognized).<sup>5</sup> The section 272 safeguards are designed to reveal (and discourage) BOC discrimination against interLATA competitors and in favor of their own long-distance affiliates and BOC subsidization of those long-distance affiliates by recovering the affiliates’ costs from local and exchange access customers.<sup>6</sup> And in the absence of those safeguards, a BOC with local market power could, with impunity, act on its incentives to engage in such discrimination and cross-subsidization.

In section 272(f)(1), Congress gave the Commission authority to “sunset” the section 272 safeguards three years after a BOC is authorized under section 271 to provide in-region interLATA services. 47 U.S.C. § 272(f)(1). But Congress never expressed the view, either in the Act or its legislative history, that the section 272 requirements *should* be terminated at the end of three years. To the contrary, Congress merely recognized that it could not predict how long it would take for local competition sufficient to dissipate a BOC’s local market power to develop. Section 272(f)(1) reflects Congress’ recognition that it would take *at least* three years for that to happen, but could well take much longer. Congress thus granted the Commission authority to assess market conditions and maintain the section 272 safeguards as long as necessary to protect the public interest. It is now all too clear that, even in the best of

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<sup>5</sup> *E.g.*, *SBC/Ameritech Merger Order* ¶¶ 12-16, 190; *Non-Accounting Safeguards Order* ¶ 9, 11-13; *see id.* ¶¶ 1-63, 216.

<sup>6</sup> “Congress . . . enacted section 272 to respond to the concerns about anticompetitive discrimination and cost-shifting that arise when the BOC enters the interLATA services market in an in-region state in which the local exchange market is not yet fully competitive.” *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act*, FCC 97-222, CC Docket No. 96-149, Second Order on Reconsideration (released June 24, 1997), ¶ 5.

circumstances, it will take far longer than three years following interLATA authority for any BOC's local market power to come to an end. Even in states like New York and Texas, where the BOCs were granted interLATA authority years ago, they retain substantial and undeniable local market power.

In evaluating whether to allow the section 272 requirements to sunset, therefore, the core consideration, as it was when section 272 was enacted, must be market power. *See Non-Accounting Safeguards Order* ¶ 13 (section 272, and implementing rules and policies, would apply "until facilities-based alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary"). Until a BOC's market power has dissipated, the reasons for each of the section 272 requirements remain, and no rational basis exists for finding that either the public interest or competition will be served by their elimination. Viewed under this market power lens, it is plain that current circumstances demand extension of the section 272 requirements beyond the initial three-year period.<sup>7</sup> There is quite simply no principled basis to allow these critical safeguards to terminate, because experience has demonstrated that they serve the same important purposes three years after a BOC's interLATA entry as they do the day after that entry.

**B. BOCs Retain Significant Market Power In All Markets, Even Years After Section 271 Approval.**

The Commission concluded just last year that "incumbent LECs retain market power in the provision of local services within their respective territories."<sup>8</sup> That is no less true of

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<sup>7</sup> Notably, in the long distance market eleven years passed after the market was fully open to competition before the Commission viewed AT&T's market power to have dissipated sufficiently for it to be declared a "nondominant" carrier. *Motion of AT&T Corp. To Be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271, ¶ 32 (1995).

<sup>8</sup> *1998 Biennial Regulatory Review*, 16 FCC Rcd. 7418, 7438 (2001); *see Declaration of Lee L. Selwyn on Behalf of AT&T Corp.*, ¶ 17 (Aug. 5, 2002)(Attachment 1 hereto) ("Selwyn Dec.").

BOCs that long ago obtained interLATA authority, and this basic fact demands that the section 272 safeguards remain in place. The *Notice* properly recognizes that the Commission could “support the sunset of [section 272] statutory requirements” only if and only when competitive “circumstances [have] *changed* in three years.”<sup>9</sup> Only *after* both unaffiliated long-distance providers and residential and business consumers have ubiquitous real world alternatives to a BOC’s exchange access and local exchange services throughout the state could the BOC “be constrained” in its ability to misallocate costs and to discriminate against competing providers of interexchange service. *Notice* ¶ 12.

The realities of the BOCs’ local telephone markets lag far behind these utopian conditions – as the Chairman recently recognized. See “FCC’s Powell Says Telecom ‘Crisis’ May Allow A Bell To Buy WorldCom,” Wall St. J., at A1, A4 (July 15, 2002) (the Commission “tended to over-exaggerate how quickly and how dramatically [the local markets] could become competitive”). Even in the largest and most competitively-advanced markets in the country, BOCs, including those that have long had interLATA authority, have been found to “continue[] to dominate the market overall” and to control “bottleneck” facilities that BOC “competitors [must] rely on.”<sup>10</sup> Given these indisputable facts, and under the Commission’s established tests for market power, all of the BOCs – even those that the Commission has determined opened their local markets and met all of the section 271 requirements nearly three years ago – undoubtedly

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<sup>9</sup> *Notice* ¶ 12 (emphasis added); cf. *Motor Vehicle Manu. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) (“the forces of change do not always or necessarily point in the direction of deregulation”).

<sup>10</sup> *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, Case 00-C-2051, (NYPSC June 15, 2001) (“*NYPSC Special Access Order*”); see also Cal ALJ Decision at 258 (“actual competition in California” has maintained its “current anemic pace”); Comments of the Tex. Public Utility Counsel at 2-3 (describing the “extremely low levels of competitive entry in Texas” and concluding that “circumstances have not changed” because “BOCs still retain monopoly control”).

remain dominant and retain the ability not only to raise prices above competitive levels, but to engage in cost misallocations and to discriminate against their rivals. It is indisputable that even where the BOCs have won approval pursuant to section 271, the competing carriers that have entered the BOCs' local markets have yet to make effective strides to erode the BOCs' dominance, and they certainly are not yet in the position of being able to provide reliable and ubiquitous alternative sources of supply that would constrain the BOCs' ability to misallocate costs or discriminate against rivals. Because the market conditions that led Congress to enact section 272 (*i.e.*, a BOC with very high market share and continued control over bottleneck facilities) have not materially changed, the Commission should extend the requirements of section 272 for at least an additional three years.

**1. BOCs Continue To Be Dominant And Retain Very High Local Market Shares, Even In the Most Competitive Local Markets.**

Six years after the Act was enacted, the BOCs still possess overwhelming market power and remain the dominant providers of all local services in all markets across the country. As Dr. Lee L. Selwyn demonstrates in his attached testimony, "[t]he BOCs' local market power has not materially diminished since 1997." Selwyn Dec. ¶ 17. As the Commission repeatedly has held, a carrier may exercise market power in at least two ways: (1) "by restricting its own output" or (2) "by increasing its rivals' costs or by restricting its rivals output through the carriers' control of an essential input, such as access to bottleneck facilities, that its rivals need to offer their services."<sup>11</sup>

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<sup>11</sup> See *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Second Report and Order, 12 FCC Rcd. 15756 ¶ 83 (1997) ("*LEC Classification Order*"). Significantly, under the Commission's existing rules, ILECs are generally classified as "dominant" carriers, which are defined as carriers that possess market power. 47 C.F.R. § 61.3(q).

Each of the BOCs has market power over virtually all exchange and exchange access services. ILECs still provide in excess of 90% of exchange and exchange access services, and their facilities are essential inputs in all but a small fraction of the services that are now offered by competing carriers. *See* Selwyn Dec. ¶ 22.<sup>12</sup> Here, the dispositive fact is that the ILECs continue to control essential bottleneck local access facilities. Even if (because of regulatory constraints) a BOC could not raise prices by unilaterally restricting its own output, bottleneck facilities nonetheless give it the ability to exercise market power in myriad other ways. As the Supreme Court just explained, “[i]t is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage, not only in routing calls within the exchange, but, through its control of this local market, in the market[] for . . . long-distance calling as well.” *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1662 (2002).

Because of their control over local exchange bottleneck facilities, the ILECs can raise their rivals’ costs and restrict their rivals’ output by denying and/or delaying access to essential inputs and by engaging in cross-subsidization and price squeezes. *See LEC Classification Order* ¶¶ 100, 158; *Non-Accounting Safeguards Order* ¶¶ 9-13; *see also Verizon*, 122 S. Ct. at 1662 (The carrier that controls the “local loop plant” could “place conditions or fees

<sup>12</sup> *See also* Declaration of Robert Willig ¶ 13 (“Willig Decl.”) (submitted in Docket No. 01-337) (March 1, 2002). In a number of ongoing proceedings before the Commission, AT&T has demonstrated that ILECs maintain market power in local markets by virtue of their control over bottleneck facilities. For example, in response to the Commission’s NPRM regarding the regulatory treatment of various ILEC broadband services, AT&T submitted extensive comments and testimony (including Professor Willig’s declaration) demonstrating that the ILECs possess market power in local markets that they can use to harm their rivals in the broadband market. *See* Comments of AT&T Corp., at 19-50, CC Docket 01-337 (filed March 1, 2002) (“AT&T Broadband Dominance Comments”). Likewise, in urging the Commission to adopt performance measures for ILECs’ provision of special access services, AT&T demonstrated that the ILECs retain market power with respect to those services. Comments of AT&T Corp., at 3-13, CC Docket No. 01-321 (filed Jan. 22, 2002) (“AT&T Special Access Comments”).

... on long-distance carriers seeking to connect with its network”). It is this control over bottleneck facilities that makes the BOCs dominant over exchange and exchange access services generally. Indeed, the Commission has found that “incumbent LECs . . . have the incentive and ability” to use their control over bottleneck facilities “to discriminate against competitors in the provision of advanced services” and to restrict their output. *SBC-Ameritech Merger Order* ¶ 186; *see id.* ¶¶ 196-97.

Under the Commission’s precedents, “control of bottleneck facilities” is “[a]n important structural characteristic of the marketplace that confers market power upon a firm” and is “prima facie evidence of market power.”<sup>13</sup> Here, moreover, it is quite clear that the BOCs have in fact exercised market power through their control over bottleneck facilities. As explained below, the BOCs continue to use this bottleneck control to misallocate costs and to discriminate against unaffiliated interLATA service providers. For these reasons, it is critical that the Commission continue to apply section 272 and other regulatory safeguards to help detect and discourage such anticompetitive conduct. *Verizon*, 122 S. Ct. at 1662 (“*In an unregulated world*, another telecommunications carrier would be forced to comply with the[] conditions” the incumbent local carrier imposed, or else the competing carrier “could never reach the customers of a local exchange”) (emphasis added).

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<sup>13</sup> *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, First Report & Order, 77 F.C.C.2d 308, ¶ 58 (1979). Thus, when the Commission first concluded that “AT&T must be treated as dominant,” it did so, in part, because it concluded that “many of AT&T’s competitors must have access to [AT&T’s] network if they are to succeed.” *Id.* ¶ 62. Conversely, when the Commission later reclassified AT&T as non-dominant, it did so, in part, because, “as a result of divestiture, AT&T no longer own[ed] bottleneck local access facilities.” *AT&T Reclassification Order* ¶ 32.

**2. There Are Generally No Alternative Sources Of Exchange Access Services And Local Exchange Service Alternatives Remain Extremely Limited.**

Throughout the nation, AT&T and other interLATA providers remain heavily dependent upon the BOCs for access to bottleneck facilities.<sup>14</sup> As much as AT&T and other competitive carriers would prefer to self-provide last-mile facilities, or obtain them from non-incumbent sources, the BOCs remain the only sources for these facilities within their territories in the overwhelming majority of situations.<sup>15</sup> As the Commission recognized in the *UNE Remand Order*, self-provisioning is not a viable alternative because “replicat[ion of] an incumbent’s vast and ubiquitous network would be prohibitively expensive and delay competitive entry.”<sup>16</sup> The ILECs have ubiquitous transport facilities that connect 14,000 local serving offices and over 220 million loops.<sup>17</sup> No CLEC or IXC can hope to replicate this network. *See Verizon*, 122 S. Ct. at 1662.

Accordingly, even in states like New York, where it has been nearly three years since the BOC won section 271 authority, there are not yet significant alternative sources of

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<sup>14</sup> This is true regardless of the nomenclature used to describe those facilities (*i.e.*, “transport” and loops” where competitors seek unbundled elements, versus “channel mileage” and “channel terminations” in the case of special access). AT&T Broadband Dominance Comments at 4-27; AT&T Special Access Comments at 3-13.

<sup>15</sup> In the Commission’s Triennial Review proceeding, AT&T has provided substantial evidence and testimony explaining why ILECs control these facilities, and the difficulties competing carriers face in replicating them. *See, e.g.*, Reply Comments of AT&T Corp., CC Docket No. 01-338, at 144-87, 244-68 (filed July 17, 2002) (“AT&T Triennial Review Reply Comments”); *id.* Exh. C, Reply Declaration of Anthony Fea and Anthony Giovannucci, (“Fea/Giovannucci Reply Dec.”); *see also* Declaration of Anthony Fea and William Taggart, CC Docket No. 96-98 (filed April 30, 2001, appended to Comments of AT&T) (“Fea/Taggart Dec”).

<sup>16</sup> Third Report And Order And Further Notice Of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd. 3696 (1999) (“*UNE Remand Order*”); *see also* AT&T Triennial Review Reply Comments at 144-87, 244-68; Fea/Giovannucci Reply Dec.

<sup>17</sup> *See* Federal-State Joint Board, *Universal Service Monitoring Report*, Tables 10.1, 10.2 (Oct. 2001).

supply to the BOCs' bottleneck facilities. As Dr. Selwyn explains, although competing local carriers serve about 20 percent of the statewide retail customers, the local market with the highest rate of CLEC penetration (Rochester) is not even served by Verizon. Selwyn Dec. ¶¶ 23, 25. And many markets in New York have yet to see *any* competitive entry. *Id.* In fact, according to the NYPSC, market share for Verizon's local service competitors *decreased* in the second quarter of 2001. *Id.*

Likewise, in Texas, the second state in which a BOC received section 271 authority, the comments filed by the Public Utility Commission of Texas demonstrate that SBC has "continued dominance over local exchange and exchange access services," which "hinders the development of a fully competitive market." Texas PUC Comments, WC Docket No. 02-112, at 3 (filed July 25, 2002). Thus, the Texas PUC has previously reported that the level of market penetration was "too low to declare that full competition has arrived."<sup>18</sup> That is not surprising, because in 1999, ILECs in Texas controlled over 91 percent of all access lines and nearly 95 percent of residential and small business lines – and since that time, competition has not significantly grown, as "a number of key competitors" have been forced by market conditions to "limit[] their entry" and have "not been offering substantial competition" in bundled offerings of services.<sup>19</sup> Under these conditions, new entrants can do little to constrain the anticompetitive practices of the dominant BOC.

Critically, Verizon and SBC retain this dominance even though New York and Texas are among the country's most active markets and ones in which state regulators have

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<sup>18</sup> See Comments of Texas Office of Public Utility Counsel, WC Docket No. 01-148 (filed July 17, 2002) (quoting Report to the 77<sup>th</sup> Texas Legislature, *Scope of Competition in Telecommunications Markets of Texas*, January 2001, p. ix-x).

<sup>19</sup> *Id.*; Texas PUC Comments at 3, 4 ("Even in states with section 271 approval, competition is still emerging, . . . and many competitors are struggling to remain financially viable").

demonstrated a strong commitment to fostering local competition. But in many other states where the BOC has section 271 authority, competitive entry has been much more limited, and the prospects for future development of competition are far more dim. For example, as Dr. Selwyn points out, in Kansas and Oklahoma (the third and fourth states in which BOCs won section 271 approval), new entrants still provide only about 8 and 6 percent, respectively, of the retail services. Those figures will not likely increase rapidly (and may even have decreased (Selwyn Dec. ¶ 26), both because competing carriers active in those states have filed for bankruptcy, and because BOCs in those states do not offer access to their unbundled elements at prices that enable carriers to offer a profitable competitive service.<sup>20</sup>

As the experiences in Kansas and Oklahoma demonstrate, local competition does not inevitably accelerate once the BOC wins section 271 approval. Indeed, Dr. Selwyn offers statistical evidence showing that states with BOC interLATA approval do not have any significantly higher rates of CLEC facilities-based penetration than states without BOC interLATA authority. Selwyn Dec. ¶¶ 27-28 & Att. 2.<sup>21</sup> Accordingly, any expectation that BOC market power will entirely dissipate within three years of interLATA entry – or in *any* fixed period – simply does not accord with the actual marketplace conditions – which, as described above, is plainly what Congress intended the Commission to consider in deciding whether it should maintain the section 272 safeguards. *See Non-Accounting Safeguards Order* ¶¶ 9, 13.

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<sup>20</sup> Dr. Selwyn explains that the BOCs' continued market power is also demonstrated by the fact that the BOCs have abstained from invading other BOCs' territories, even when they have committed to doing so. Selwyn Dec. ¶ 31.

<sup>21</sup> Dr. Selwyn also explains that the experiences in Connecticut, Hawaii, and in the former GTE territories corroborate the conclusion that a BOC's ability to offer interLATA services does not spur local competition. In those areas, the dominant LECs have long been able to offer interLATA services, yet local competition there remains low. Selwyn Dec. ¶¶ 28-29.

Although the BOCs' dominance extends to all local markets and services, it is the BOCs' enduring market power over access services, and particularly special access services, that is most important in this context.<sup>22</sup> It is the ILECs' dominance in the provision of these wholesale services that is the direct source of their ability to impede competition in the retail market for long-distance services that section 272 is designed to keep fully competitive even after entry by BOC affiliates.<sup>23</sup>

In this regard, the findings of the New York Public Service Commission ("NYPSC") that Verizon remains the "dominant" provider of special access services in *all* of that state, *including* lower Manhattan – the area that is generally regarded as the *most* competitive in the United States – is compelling proof of the BOCs' continuing market power. *NYPSC Special Access Order* at 6-9. The NYPSC carefully analyzed a detailed record regarding route miles of fiber, numbers of buildings passed and especially numbers of buildings actually *connected* to ILEC competitors, and concluded that "Verizon's combined market share data demonstrates its

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<sup>22</sup> See AT&T Special Access Comments at 3-13. IXC's use special access facilities to provide both traditional voice services and more advanced services like frame relay and ATM services. Although special access services use the very same loops and transport facilities that are provided as unbundled network elements, CLECs serving larger business customers must generally secure access to ILEC loops, transport, and combinations thereof via special access tariffs. The principal reason is the Commission's decision to permit ILECs to limit the manner in which CLECs may use combinations of the loop and transport elements. See AT&T Triennial Review Reply Comments at 283-300.

<sup>23</sup> See, e.g., Comments of Sprint Corporation, *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket No. 01-321, at 5 (Jan. 22, 2002) (noting that it "continues to rely upon the ILECs for approximately 93% of its total special access needs despite aggressive attempts to self-supply and to switch to facilities offered by alternative access vendors (AAVs) whenever feasible"); Comments of WorldCom, Inc., CC Docket No. 01-321, at 5 (Jan. 22, 2002) (explaining that "[i]n the past year, approximately 90 percent of . . . [its] off-net special access circuit needs were provisioned by the incumbent LECs, even though it is . . . [its] policy to use the local facilities of WorldCom or other competitive carriers whenever such facilities are available"); Comments of VoiceStream Wireless Corporation, CC Docket No. 01-321, at 5 (Jan. 22, 2002) ("CMRS carriers remain heavily dependent on the special access facilities provided by the ILECs."); Reply Comments of Sprint Corporation, CC Docket No. 01-321, at 2 (Feb. 12, 2002) ("There is virtual unanimity among commenting IXCs, CLECs, CMRS providers, and large

continued dominance in *all* geographic areas. . . . In [New York City], for example, Verizon has 8,311 miles of fiber compared to a few hundred for most competing carriers; Verizon has 7,364 buildings on a fiber network compared to less than 1,000 for most competing carriers.” *Id.* at 7. Verizon’s own data show that “a maximum of 900 buildings [are] served by individual competitors’ fiber facilities,” but New York City has “775,000 buildings in the entire city, over 220,000 of which are mixed use, commercial, industrial, or public institutions.” *Id.* at 7-8 (citing to Land Use Facts, Department of City Planning). The NYPSC further concluded that claims regarding “buildings passed” by competitors’ facilities were virtually meaningless as evidence of a competitive market because “the data do not reflect how often fiber actually enters those buildings.” *Id.* at 9. “Because competitors rely on Verizon’s facilities, particularly its local loops,” the NYPSC found, “Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services.” *Id.* The NYPSC thus concluded that “Verizon’s combined market share data demonstrate its continued dominance in *all* geographic areas” *Id.* at 9 (emphasis added).

If interLATA competitors are still so dependent on BOC-supplied special access facilities in New York City, it is obvious that BOCs retain market power elsewhere. As Dr. Selwyn describes, other state commissions have likewise expressly determined that BOCs continue to be “dominant local exchange provider[s],” which retain “the incentive and capability to exercise market power.” *See* Selwyn Dec. ¶ 20. And there is no basis to believe that the

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end users that ILECs remain dominant in the provision of special access services”); Reply Comments of Cable & Wireless USA, Inc., CC Docket No. 01-321, at 2-11 (Feb. 12, 2002).

BOCs' overwhelming market power will dissipate in the foreseeable future. In most cases, it is simply not feasible for competitors to build facilities directly to the end user's premises.<sup>24</sup>

The BOCs' market power with regard to access services is not limited to special access. As with special access, the IXC generally has no alternative to the BOCs' switched access services. Indeed, the market conditions for switched access services are even *less* competitive: where competitive carriers have entered local markets, the Commission has found that even those carriers obtain a "series of bottleneck monopolies over access to each individual end user." Seventh Report and Order, *Access Charge Reform*, 16 FCC Rcd. 9923, ¶ 30 (2001). Many competitive carriers exploited those monopolies to impose rates that exceeded those charged by the BOCs – causing the Commission to limit the switched access rates that competing carriers could charge. *Id.* ¶¶ 2, 22, 45. Under these market conditions, where even many competing carriers are pricing at supracompetitive rates, there can be no doubt that the few "alternative sources" for access are not acting to "constrain[]" the BOCs' "ability to discriminate against competing providers of interexchange service." *See Notice* ¶ 12. Accordingly, BOCs undoubtedly maintain market power over switched access services as well.

In short, there is overwhelming real world evidence that the BOCs' local market power is not significantly reduced, even years after they win approval pursuant to section 271 to offer in-region, interLATA services. So long as a BOC maintains market power over access and other bottleneck facilities, it can leverage that power to favor its own interLATA operations and

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<sup>24</sup> New network construction typically requires cooperation from localities, other carriers, and building owners and can take months or even years to complete. Most end users are unwilling to deal with these delays. Even in those limited instances in which it is economically feasible to deploy facilities, CLECs face a number of hurdles that frustrate the self-deployment of facilities, including the need to obtain access to rights-of-way and buildings, existing ILEC volume or term commitments, exhaustion of collocation capacity, and long distances between points of presence and ILECs' end offices. *See* Fea/Taggart Decl. ¶¶ 30-31; AT&T Triennial Review Reply Comments at 144-87, 244-68; Fea/Giovannucci Dec.

disfavor those of competitors. *Verizon*, 122 S. Ct. at 1662; *Non-Accounting Safeguards Order* ¶¶ 9-13. Under those conditions, the section 272 structural separation and nondiscrimination rules play a vital role – where vigorously enforced – in detecting BOCs’ misconduct.

**C. BOCs Continue To Misallocate Costs And To Discriminate Against Unaffiliated InterLATA Competitors.**

As set forth below and in Dr. Selwyn’s declaration, the BOCs, including those that have long had interLATA authority continue to engage in improper cost misallocation and discrimination against unaffiliated interLATA providers. These following examples simply confirm the BOCs’ continuing local market power and their incentive and ability to harm long distance competition. And, as the Commission has long recognized, evidence that a BOC is, in fact, able to misallocate costs or to engage discriminatory conduct is direct evidence of market power. *E.g.*, *SBC-Ameritech Merger Order* ¶ 107. As the *Notice* indicates (¶ 15), the Commission should therefore consider evidence of such behavior in determining whether to maintain the section 272 safeguards. Such evidence also demonstrates the role that the section 272 safeguards can play, when vigorously enforced, in detecting such conduct, and facilitating remedial action to ensure the interLATA market remains a “level playing field.” *See* Texas PUC Comments at 6 (section 272 is the “only statutory means of monitoring [SBC]’s obligation to provide access to its network”).

*All* such evidence of discrimination and cross-subsidization is relevant here. There is no basis, as the *Notice* suggests (¶ 15), to consider only formal complaints or “final regulatory or judicial findings” of discrimination or other anticompetitive conduct. Although final determinations of liability might be deserving of more *weight* than other types of evidence, all credible evidence of cost misallocations and discriminatory behavior supports a finding that the